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January 29, 2007

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DOCKETED

JAN 29 2007

Mr. Raymond S. Heyman
UniSource Energy Corporation
One S. Church Ave., Suite 1820
Tucson, AZ 85701-0001

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RE: Meetings to Propose Joint Resolutions In Docket No. E-01933-05-0650

Dear Mr. Heyman:

On January 22, 2007, you sent a letter with the above subject line, addressed to each of the Commissioners, Parties to the 1999 Settlement Agreement, and Interveners in the referenced docket. The letter purports to be a request for a meeting pursuant to Section 13.2 of the 1999 Settlement Agreement. While Staff is generally willing to engage in discussions of issues at any time, it is unclear whether TEP's proposed meetings would be a productive exercise for the reasons discussed below. Furthermore, the choice by TEP to invoke the 1999 Settlement as the basis upon which to request discussions necessitates some comments on behalf of Staff.

With respect to the statements in your letter that there are divergent views of the status of retail electric competition in Arizona and in the interpretation of the 1999 Settlement, it is unclear to Staff why those self-evident statements have any special import at this time. This proceeding was commenced with your filing of a Motion to Amend your 1999 Settlement in September of 2005. By that time, TEP had already participated in the Commission's Track "A" and Track "B" proceedings; had explicitly requested—and been granted—relief from the obligation to divest its generation assets; and was certainly aware of the proceedings that resulted in the *Phelps Dodge* decision. At every stage of those matters, TEP must have observed that other Parties held differing views from theirs on these matters. It remains a mystery to Staff why TEP chose the time and manner that it did to raise these questions by filing the instant Application. TEP's recent request to "meet and confer" less than a month before the hearing is scheduled to begin is even more perplexing.

It is also unclear what TEP believes the role of the Commission to be in connection with the discussions it seeks. TEP is well aware that Commission Staff was not a Party to the 1999 Settlement. In addition, despite the provisions of Section 13.3 of the Settlement Agreement, the Commission was not a Party to the Settlement either.

The Commission issued its regulatory Order, approving the Settlement Agreement in Decision No. 62103. The fact that it left Section 13.3 in place does not alter the Commission's role as a regulatory body which approved a Settlement negotiated by some Parties. The approval of the 1999 Settlement does not change the Commission's authority or obligations under Article 15 of the Arizona Constitution. Under the Arizona Constitution, the Commission is charged with regulating TEP as a public service corporation. That charge extends to establishing just and reasonable rates for TEP, based upon the fair value of its property devoted to public service in the state. Whatever meaning TEP may ascribe to the recitation in the 1999 Settlement that the Commission became a Party to the Settlement by virtue of having approved it, the Commission's authority and obligations remain unaffected. Even if the Commission were a party to the settlement agreement, the prospect of the Commission's simultaneously engaging in settlement discussions *and* serving as the forum for the resolution of TEP's pending application presents certain substantive and procedural complications that are better avoided, especially at this late state of the proceeding.

Furthermore, Staff does not believe that the process proposed by TEP is fair and appropriate in the context of its pending proceeding. If Settlement discussions were convened in connection with this docket, all Parties to the docket should be notified and have the opportunity to participate. Based on previous direction from the Commission, Staff would decline to participate in any Settlement discussions that fail to provide an opportunity for participation of all Parties.

Finally, Staff tends to believe that TEP's failure to adequately develop its case in the pending proceeding is not conducive to meaningful Settlement discussions. It is Staff's perspective that TEP has never provided proposals in sufficient detail or with adequate support to allow a decision in this matter that will resolve the necessary issues to establish rates for TEP after January 1, 2009. In the absence of an adequate development of the facts, Staff's ability to meaningfully engage in Settlement discussions would surely be hampered, thereby raising questions regarding the benefit of Settlement discussions.

Nonetheless, as I indicated at the beginning of this letter, Staff remains willing to participate in discussions with TEP in an attempt to narrow or resolve any issues upon which we disagree. From Staff's perspective, we would hope that any such discussions would be inclusive, as well as amicable, professional and productive.

Sincerely,



Christopher C. Kempsey
Chief Counsel, Legal Division

CCK:mam

Cc: Docket Control
Service list for Docket No. E-01933-05-0650
Commissioners Hatch-Miller, Mundell, Gleason, Mayes and Pierce (Hand-Delivered)
Ernest Johnson